Special Report

To the
Legislative Assembly

The Lottery Fund:
An Audit of the
Granting Process

PROVINCE OF
BRITISH COLUMBIA

AUDITOR GENERAL OF BRITISH COLUMBIA

Legislative Assembly
Province of British Columbia

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The Honourable Austin F.C. Pelton
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Sir:

In accordance with the authority contained in the Auditor General Act, RSBC 1979, I submit to the Legislative Assembly of the Province of British Columbia this special report entitled, The Lottery Fund: An Audit of the Granting Process.

George L. Morfitt, F.C.A.
Auditor General

Victoria, British Columbia
February 27, 1990

c.c. The Honourable Stephen C. Rogers
Speaker Designate of the Legislative Assembly

The Lottery Fund: An Audit of the Granting Process

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The Lottery Fund: An Audit of the Granting Process

Introduction

As part of my scheduled audit program for the year, my staff reviewed controls and practices employed by the government in its management of grants paid from the Lottery Fund. We focused on application, assessment, and monitoring practices, selecting a sample of project files for which transactions had occurred during the fiscal year ended March 31, 1989.

While our audit was in progress, the then Minister of Tourism and Provincial Secretary directed the Comptroller General to investigate and report on the circumstances surrounding two grants to the Semiahmoo House Society. The grants were made under the program known as Growth and Opportunities B.C. (GO B.C.) and were authorized and paid in the 1989/90 fiscal year. The Comptroller General was also directed to look at the GO B.C. grant process in general. Because of the planned coverage of the Comptroller General's investigation, I decided not to look further at the GO B.C. grants, pending the results of the Comptroller General's investigation. I did, however, direct my staff to expand their audit of other grants paid during the 1988/89 fiscal year.

The Comptroller General's investigation is now complete and his report has been issued. I have reviewed the report and conclude that it deals with the grants in question in a comprehensive manner. Also, I am in general agreement with the Comptroller General's recommendations concerning the process for GO B.C. grants; those recommendations are equally applicable to the other types of Lottery Fund grants.

The Comptroller General concluded that the specific grants which he investigated were "irregular in relation to normal program guidelines." In our own review, we found a number of situations where program guidelines were not consistently applied. Significant ministerial discretion is provided by the *Lottery Act*, and has been exercised by each Provincial Secretary, in his or her turn. There is no established process for dealing with exceptions to published grant program guidelines, or with grants that fall outside established programs. The standard of documented support for grant approvals varied considerably, and the reasonableness of project costs was generally not assessed.

According to the Comptroller General, there was an undisclosed non-arms-length relationship between the Minister at the time and third party suppliers in respect of one of the Semiahmoo grants. In circumstances where control and review processes are not fully adequate, there is increased potential for unidentified conflicts of interest in regard to any grant made.

For me to confirm the presence or absence of non-arms-length funding relationships or conflicts of interest would necessitate a special investigation of each

grant, involving legal counsel and other outside specialists. Because of this fact, and because, in our review, we found no evidence that grants were made to non-bona-fide organizations or were made for purposes that did not appear to have some community benefit, I have decided not to further extend our review of this issue.

I believe that the government should carefully consider the findings contained in both this report and that of the Comptroller General, and take the necessary steps to strengthen controls over lottery grants.

This report relates to the management of all grants from the Lottery Fund and does not just focus on one grant or grant program. I am issuing it at this time, rather than awaiting the publication of my Annual Report, as I consider that, in light of the Comptroller General's report, it is in the public interest to do so.

Audit Purpose

The purpose of our audit was to determine if controls and practices promote equitable access to lottery grants, and provide reasonable assurance that grants are used by recipients for approved purposes.

The two ministries which administer most of the lottery grant programs are the Ministry of Provincial Secretary (Provincial Secretary) and the Ministry of Municipal Affairs, Recreation and Culture (Municipal Affairs). We focused on application, assessment, and monitoring practices employed by these ministries, and selected a sample of grant files for which transactions had occurred during the 1988/89 fiscal year.

Conclusions

The *Lottery Act* gives the Minister (currently the Provincial Secretary) broad discretion over the nature and amount of expenditures from the Lottery Fund. The Fund is also specifically excluded, by government management policy, from expenditure restrictions and approval and reporting requirements set by Treasury Board under the *Financial Administration Act*. These circumstances do not, however, diminish the responsibility of the Minister to be able to demonstrate that the grant approval process promotes equitable and consistent treatment of all applications.

In summary, we have drawn the following conclusions as a result of our examination within the two principal ministries involved.

Provincial Secretary

We found that the guidelines for regular capital grant programs are not being consistently followed. For special grant funding (that which is not initiated through regular grant program procedures and which often does not fall within the scope of regular grant programs), we found that no guidelines have been established. Furthermore, the availability of such funding has not been well communicated to the public. We also found that the reasonableness of the underlying project costs was generally not assessed, and that there were instances of grants being approved without documented evaluation of eligibility. It is unclear, therefore, if equitable access to lottery grants is being provided. While procedures and practices for monitoring approved use could be improved, they generally provide reasonable assurance that grants are used for approved purposes.

Municipal Affairs

Procedures and practices for cultural services grants promote equitable access to grants and provide reasonable assurance that grants are used for approved purposes. Grant evaluation and monitoring procedures for recreation and sports grants need to be improved.

Lottery Grants: An Overview

The *Lottery Act* (the Act) specifies that proceeds from the conduct of lotteries in the Province may be "paid out for cultural or recreational purposes or for preserving the cultural heritage of the Province or for any other purpose the Minister considers to be in the public interest." In the 1970's, a total of $14.5 million of lottery grants was paid out under this Act. Circumstances changed rapidly in the 1980's, as lottery revenue grew and the amount available for grant funding grew with it (see Figure 1). In the 1988/89 fiscal year alone, over 4000 lottery grant payments, totalling approximately $83.1 million, were made.[1]

Lottery grants are made to a wide range of community organizations through a variety of programs. The Provincial Secretary is charged with administering the Act and, accordingly, is the final authority as to what constitutes a valid grant payment.

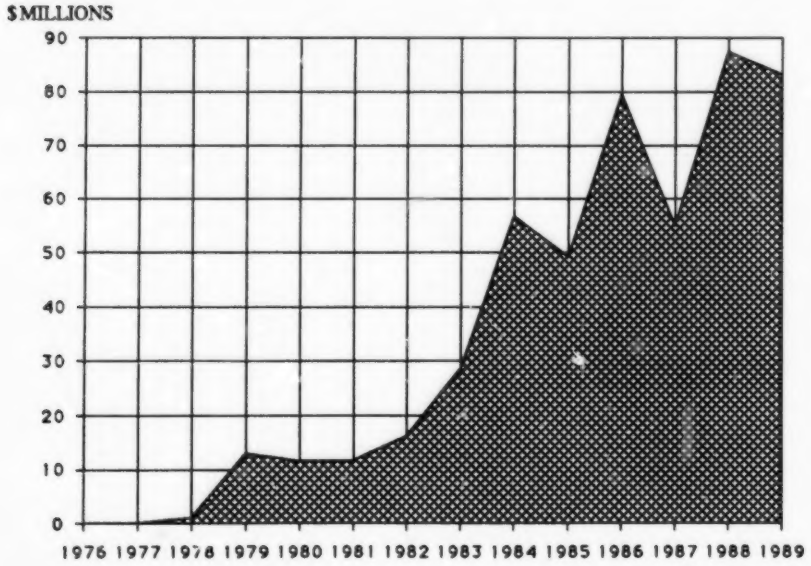

FIGURE 1.

Lottery grants, excluding transfers to other government special purpose funds or accounts, made during the 1975/76 to 1988/89 fiscal years. The 1987 amount also excludes the payment of the Expo '86 deficit.

Source: Public Accounts of British Columbia

[1] Excludes transfers to other government special purpose funds or accounts.

While this responsibility covers all lottery grant programs, the actual administration of certain programs has been delegated to other ministries and government agencies (see Figure 2). Health research grants are handled by the British Columbia Health Care Research Foundation, and funding to the film industry is administered through the Film Development Society of British Columbia (B.C. Film). Grants for culture, recreation, sport, downtown revitalization, and heritage programs are handled by Municipal Affairs, although it delegates the administration of most heritage grants to British Columbia Heritage Trust, and handles municipal downtown revitalization projects through a ministry-controlled society. Our review focused on grant programs directly administered by the two ministries of Provincial Secretary and Municipal Affairs.

Provincial Secretary

Lottery grants administered directly by Provincial Secretary are primarily for the partial funding of one-time capital projects. These projects include the purchase of equipment, the building of community facilities, and the start-up costs of public attractions such as Science World in Vancouver. The Ministry also handles a large number of small in-province travel grants for school groups and other organizations, and donations to charities.

In most cases, the Ministry evaluates projects through defined programs and uses standard grant applications. These exist for in-province travel grants, regular capital grants, and GO B.C. grants. In other cases, special grant funding is provided for capital

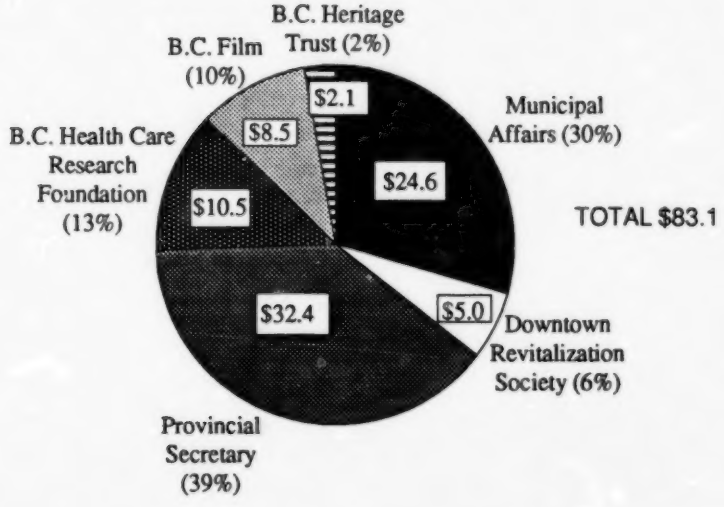

FIGURE 2.

Lottery grants, excluding transfers to other government special purpose funds or accounts, made in the 1988/89 fiscal year ($ in millions).

Source: Ministry of Provincial Secretary

projects or special events that the Minister or the government decides are worthwhile, but which do not fit into already defined programs. Some of these grants arise from external requests; others are initiated by the Minister or the government.

In the 1988/89 fiscal year, Provincial Secretary made Lottery Fund expenditures totalling $32.4 million, excluding $19 million which was paid to B.C. Film and British Columbia Health Care Research Foundation to administer (see Figure 3).

Capital grants for the 1988/89 fiscal year included special funding of $6.2 million for Science World and $1 million for the Sidney breakwater—two large, government-supported projects. In addition, $7.2 million of Expo Legacy grants were paid, including a $2.4 million payment towards the Victoria Convention Centre. Expo Legacy grants were approved by a special committee of Cabinet. Special events grants approved in the 1988/89 fiscal year amounted to about $1.9 million and included such items as a contribution to a children's support fund and financial support for a high school group to travel to the United States for an academic contest.

Equitable Access

To assess whether equitable access to lottery grants is provided, we looked to see if the Ministry made clear to target groups what funding was available and what types of projects were eligible. We also looked for an evaluation process which provided reasonable assurance that only eligible applicants and projects were funded, the costs of proposed projects were reasonable,

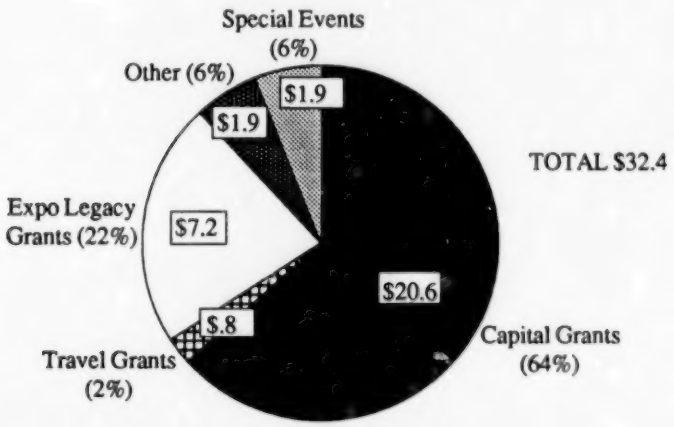

FIGURE 3.

Lottery grants, excluding transfers to other government special purpose funds or accounts, administered directly by Provincial Secretary for the 1988/89 fiscal year ($ in millions).

Source: Ministry of Provincial Secretary

and funding guidelines were applied consistently, thereby promoting consistent treatment of similar applicants. In addition, we looked for adequate accountability regarding grants made.

Establishing Guidelines

For in-province travel, regular capital, and GO B.C. grants, the Ministry publishes guidelines dealing with eligibility and funding. However, similar guidelines have not been established for special grant funding, which is dealt with on a case by case basis.

Special grants are sometimes available for projects that would have been denied funding through defined grant programs. It is unclear whether potential applicants realize the opportunity to apply for this special funding. Out-of-province travel, for example, has sometimes been funded through special events grants although it is excluded from eligibility under the travel grant program.

If potential applicants are to be given equal opportunity to access lottery grant funding, we believe Ministry guidelines should cover, as far as practical, all types of grants the Minister expects to fund. These guidelines should then be clearly communicated to the public.

Assessing Eligibility

To assess eligibility, the Ministry uses standard applications for most grants. These applications require that certain basic information be supplied. For regular capital grants, for example, applicant organizations must indicate if they are societies or other eligible organizations. They must also provide a description of the proposed project, a cost estimate, information on other funding, and an explanation of how the project will benefit a reasonably broad community base.

Eligibility guidelines for regular capital grants state that applicants must be municipalities, regional districts, local government agencies, registered non-profit societies, or non-profit societies endorsed by a local or provincial government agency. Informal groups, individuals, or businesses are excluded, as are projects for schools and post-secondary institutions. According to the guidelines, capital grants are not given for operating expenses, for expenditures incurred before the application was made, or for certain types of expenditures specifically excluded from eligibility. However, these guidelines are not applied consistently.

In some grant files, for example, we found that excluded organizations had received funding. In some other files, we found grants which funded operating costs, or provided retroactive funding, or apparently funded specifically excluded items. We noted one file where the $23,166 recommended by a project officer for a grant was increased to $65,000 by the Minister at the time, without documented explanation, effectively funding retroactive expenditures. The grant in question was also for an item specifically excluded according to the guidelines.

We believe that existing eligibility guidelines should be consistently applied—the granting of exceptions does not promote consistent and equitable treatment of similar organizations or projects. If the guidelines do not represent the desired policies of the

Minister, they should be changed and the public told about the changes. If, however, unusual circumstances arise where making of exceptions from existing guidelines is considered desirable, we believe there should be a special process for dealing with the exceptions. This process should be one that enables the Minister to demonstrate that funding decisions are equitable and supportable. One way of dealing with exceptions would be to establish an advisory committee, which is permitted under the Act.

For capital grants, project officers generally perform and document an evaluation of the eligibility of each proposed project, and make a recommendation to the Minister. However, we found several instances where grants were approved by the Minister without any documented evaluation. We believe that consistent and complete documentation of how each application or request was evaluated and why each grant was provided should be prepared to help ensure that consistent and appropriate funding decisions are made.

Project Cost Analysis and Applicant Need

We found that the Ministry has not established any standards for applicants to demonstrate the reasonableness or fair value of project cost estimates. Applicants are not required to support cost estimates with competitive bids or quotations, although in some cases applicants submit such information voluntarily. Project analysis focuses more on general benefit to the community, through enquiries made to community groups and Members of the Legislative Assembly, than on financial assessment. We also found that appropriate financial statements were not always sought by the Ministry to enable it to assess need adequately, although the financial need of the applicant is one of the evaluation criteria stated in the eligibility guidelines.

We believe, at least for larger projects, that the evaluation process should include a standard financial analysis of submitted cost estimates and financial statements, so that the Ministry can ensure that grant commitments made are reasonable, and so it can assess the financial need of the applicant. To perform this analysis adequately, the Ministry should require applicants to submit current financial statements, support for cost estimates, and, wherever possible, evidence of competitive bids or quotations.

For government-initiated special grant funding, we found that the Ministry had not always ensured that expenditures were reasonable in the circumstances or that adequate accountability of recipients was put in place. For example, Science World was funded without a formal agreement between the Ministry and Science World, although the federal government, also a funding agent for the project, had such an agreement.

In another case, the Premier's Office made a commitment in July 1987 to pay $500,000 for the production of a half hour video showcasing the Vancouver Symphony Orchestra and the Province of British Columbia, without documented analysis to determine if the cost was reasonable. A conditional grant agreement was arranged with the video producer. The agreement indicated that any proceeds received by the producer resulting from the use or disposition of the video would be paid to the Province, up to the amount of the grant. The agreement did not, however, include comprehensive

terms and conditions of performance. The agreement was later verbally renegotiated to expand the video length to one hour, for a revised total cost of $660,020. The additional $160,020 was recovered by the producer from the first sale of the video and, to November 30, 1989, the Province also had received $100,000 from video sales. The change in the terms of the grant agreement was not put in writing until the summer of 1989, at which time the wording of the original agreement was also strengthened.

We believe that large, complex funding arrangements warrant formal agreements which include terms and conditions of performance. We also believe that, where fixed cost agreements are intended, bidding should be called for whenever possible. At a minimum, where bidding does not take place, an analysis of the project cost—supported by documentation—should be done to determine if it is reasonable.

Funding Levels

For defined grant programs, published guidelines indicate the level of assistance available. For example, the current guidelines for regular capital grants state that equipment and construction projects are to be funded up to one-third of the cost. We noted several grants, however, where funding exceeded that stipulated in the guidelines. As we have already noted, the guidelines should be applied more consistently, and a standard process for dealing with exceptions should be developed.

Accountability

Publication of grants made is an effective way of allowing public scrutiny and thus providing some accountability. The Ministry annually publishes a list of the grants it has paid in the year. However, since the listing is one of payments rather than of grants approved, it does not represent complete funding commitments. We believe that a listing of grants approved, as well as grants actually paid, would be more informative.

Furthermore, the annual listings do not include all grants paid. The listing for the 1987/88 fiscal year, for example, did not include special events grants, communication grants, or donations to charities. It also showed only the total amount paid to B.C. Film and the British Columbia Health Care Research Foundation, without listing the individual grants or loans made in turn by those organizations, although detailed listings are available from the individual organizations themselves. We think the Ministry should include details of all grants in its published listing.

Monitoring Approved Use

For the over 2000 small in-province travel grant expenditures made each year, the Ministry does not specifically monitor for approved use after the fact. Instead, it limits the number of trips per organization per year, limits the maximum grant per trip to $2000, and checks the reasonableness of distance claimed. We believe this is not unreasonable in the circumstances.

For regular capital grants, the Ministry has a general policy of releasing grant monies only after the applicant has made the expenditure. An exception is the GO B.C. program where one-third of the grant can be released at the start of a project. The guidelines for regular capital grants state that

it is the applicant's responsibility to obtain any interim financing required. We found, however, that the Ministry has sometimes released funds for regular capital grants before expenditures have been made by the applicant. We believe that published guidelines should be applied consistently or be changed to correspond with desired policy.

The Ministry requires that proof of expenditure be submitted for capital grants. For construction project grants in excess of $50,000, for example, audited statements of expenditure are required before the final portion of the grant is paid. This is an effective way to monitor approved use. We found that, for non-construction projects, standards of what provides acceptable proof of expenditure have not been established. A number of general types of capital acquisitions are funded, and for each of these we believe there should be standard requirements for proof of expenditure, clearly conveyed to applicants. For purchases of real estate, vehicles, or heavy equipment, for example, we believe the Ministry should require proof of transfer of title into the name of the funded organization, as well as proof of cost.

Municipal Affairs

Municipal Affairs made Lottery Fund expenditures totalling $24.6 million in the 1988/89 fiscal year. This excluded $2.1 million given to British Columbia Heritage Trust to administer and $5 million, set aside through a ministry-controlled society, to fund current and future municipal downtown revitalization projects. Most expenditures are grants made to supplement the annual operating costs of recreation and sport organizations and cultural groups (see Figure 4). In this Ministry we focused on the cultural services and recreation and sport grant programs because they represent the two largest categories of grant expenditures.

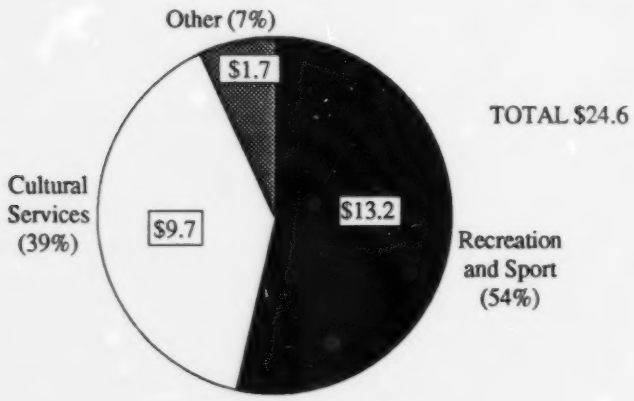

FIGURE 4.

Lottery grants, excluding transfers to other government special purpose funds or accounts, administered directly by Municipal Affairs for the 1988/89 fiscal year ($ in millions).

Source: Ministry of Municipal Affairs, Recreation and Culture

Equitable Access

Establishing Guidelines

The grants target specific types of organizations for annual funding. We found that clear eligibility criteria exist for newly applying groups, and that the Ministry communicates well to organizations about the availability of the grants and the eligibility criteria. The Ministry notifies all provincial sports governing bodies and cultural groups, on a timely basis, of application deadlines and changes in eligibility, and provides clear eligibility guidelines in standard application packages.

The Evaluation Process

Unlike Provincial Secretary, Municipal Affairs deals mostly with recurring operating grants to established organizations. So, while there are eligibility criteria for newly applying groups, assessing initial eligibility is less of an issue than deciding appropriate annual funding levels.

The Ministry requires applicants to provide information, such as budgets, projected and prior year program information and statistics, and the previous year's financial statements. Ministry staff and, in the case of the Cultural Services Branch, outside advisers are involved in evaluating eligibility and determining funding levels. The British Columbia Arts Board, for example, reviews staff recommendations for operating grants to arts organizations. In Cultural Services, standard detailed financial analysis is performed to help the Ministry ensure that suitable funding levels are provided to viable organizations. In the Recreation and Sport Branch, however, such analysis is not performed. Recreation and Sport staff do attend annual general meetings and other functions of applicant organizations but, in our opinion, this is not enough to ensure that appropriate funding level decisions are made. We believe that standard financial analysis should be performed and documented for all potential grant recipients.

Accountability

We believe that publication of grants made allows current and potential grant recipients to scrutinize the grants, and thus provides some accountability. However, publication of grants is left to the discretion of each branch of the Ministry. Cultural services grants paid are listed, by program, in an annual report; grants paid by British Columbia Heritage Trust are listed in its annual report; recreation and sports grants, and downtown revitalization grants are not published at all. We believe the Ministry should ensure the publication of all grants.

Monitoring Approved Use

The annual assessment process includes both an evaluation of the current year's requested funding and a monitoring of the previous year's usage of funds. Before making an annual operating grant, the Ministry examines how the previous grant was used. As described above, the requesting organization is required to submit the prior year's audited financial statements and program statistics.

However, analysis of financial statements is useful only when the statements can be reasonably compared to project funding, as set out in the original grant application. For

the Recreation and Sport Branch, such a comparison is often impossible because the Branch requires budget information by program, a format that is rarely used in audited financial statements. Because of this, we believe the Branch cannot be sure that funds are being spent for approved purposes. A study of the problem, already conducted by the Branch, suggested that it either change its budget submission requirements or request specialized audited information. We encourage the Branch to resolve this issue as soon as possible.

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